MTM-033895
SDR-922-91-04
3160 (922.B)

CERTIFIED MAIL
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CERTIFIED--RETURN RECEIPT REQUESTED

Decision

Chevron U.S.A. Inc.
Attention: Eric L. Dady
6400 South Fiddler's Green Circle
Englewood, Colorado 80111

SDR No. 922-91-04

SET ASIDE AND REMANDED

On November 30, 1990, a State Director Review (SDR) request was timely filed by Chevron U.S.A Inc. concerning a Lewistown District Office (LDO) decision dated November 2, 1990. In this decision the Lewistown office stated that the Dakota sand formation underlying federal lease No. MTM-033895 was being drained by the #15-8 State well located in the SW¼SE¼ Sec. 8, T. 37 N., R. 5 E., Liberty County, Montana. They further stated that since Chevron had not submitted a communitization agreement (CA) pooling the lands in said Sec. 8, the Lewistown office was assessing Chevron compensatory royalties in the amount of 9.51 percent of the production of the #15-8 State well.

Bmb 12/19
cwd 12/19

The #15-8 State well was drilled in January 1966, by Cardinal Petroleum Company as a Swift Formation oil test. Oil was not discovered in the Swift Formation, but gas reserves were encountered in the overlying Dakota sand. Cardinal Petroleum wished to produce the well as a Dakota gas well, but was prevented from doing so by the statewide spacing rules then in effect. These rules required that no gas well be located less than 1320 feet from any lease or property boundary. The #15-8 well, while legally located as an oil well test, was only about 700 feet east of the aforementioned federal lease.

Cardinal Petroleum docketed an exception request with the Montana Board of Oil and Gas Conservation (MBOGC) asking that it be allowed to operate the #15-8 well as a Dakota sand gas well (Docket No. 7-66). This docket was heard by the MBOGC at their February 10, 1966, hearing. There was no protest offered concerning Cardinal's request, and the MBOGC issued an order allowing Cardinal Petroleum to produce the well as an exception to statewide rules (Order No. 11-66).

Chevron stated that the LDO was prevented from requiring a CA for said Sec. 8 as the #15-8 State well "is not subject to either the current statewide rule or any special field rule." An analysis of the MBOGC's records indicates that Chevron's assertion is correct. Statewide rule 36.22.702, which established statewide spacing for gas as one well per governmental section, became effective on December 31, 1972, and thus does not apply in this case. Neither Chevron nor its predecessors were under any obligation to form a CA as no valid spacing unit exists.

The assessment of compensatory royalties is a viable option to protect a lease from drainage. Various Interior Board of Land Appeals (IBLA) decisions have stated that two conditions must be met prior to making an assessment for drainage. First, an assessment cannot begin until passage of a reasonable time after notice. Second, a determination must be made that a prudent operator can or could have drilled a paying protective well on the tract suffering drainage.

Concerning the first requirement, the LDO assessed Chevron in the amount of 9.51 percent of the production from the #15-8 State well beginning December 19, 1966[1]. Lewistown states that notice occurred on April 22, 1966, the date that completion data for the #15-8 State well was released by the Petroleum Information Corporation. Chevron challenges this date, stating that "Chevron and its predecessor by merger could not possibly have been on notice of the asserted drainage prior to their acquisition of the lease." To reconcile this dispute we have made our own determination as to when the date of notice was for drainage purposes.

It is our judgment that notice occurred on January 29, 1966, the date that the MBOGC publicly advertised the hearing of Docket No. 7-66 in the Montana Oil Journal (Vol. 45, No. 49). This announcement stated that Cardinal Petroleum Company was seeking permission to produce gas from a well as an exception to statewide location rules (the well was too close to the federal lease). As a prudent operator the lessee of record, Cenard Oil and Gas Company, should have realized the likelihood that the #15-8 well would drain the federal lease once production was

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[1]Had the option to form a CA been viable, and Chevron declined to do so, the amount of compensatory royalty would have been limited to 6.25 percent per paragraph .11K of the Communitization Manual (BLM Manual 3160-9).

established. Further, as both the benefits and liabilities for a lease transfer with changes in ownership (43 CFR 3106.7-2), all drainage protection obligations ultimately reside with Chevron. We concur with the LDO that Cenard could have drilled and completed an off-set well on the federal lease by December 1966. We therefore agree that December 19, 1966, meets the standard of a reasonable time after notice.

The second condition which must be met is whether or not a paying protective well can, or could have, been drilled on the tract being drained. The Lewistown District Office did not conduct a prudent operator test (paying well determination) for the drained tract as they felt that a CA was required to protect the lease. However, as explained above, it is our finding that Rule 36.22.702 does not apply to the #15-8 well. We herein set aside Lewistown's assessment of compensatory royalties, and remand the case to allow the LDO to conduct a prudent operator test for the drained tract. If this test indicates that a paying protective well could have been drilled, the LDO can re-assess Chevron for the amount of compensatory royalties due.

On a related matter, we received your SDR request on November 29, 1990. We contacted the Billings MBOGC office to inquire about hearing procedures, notice requirements, and spacing rules in effect in 1966. They stated that it would take several days to retrieve the requested data, particularly if they had to obtain the information from their Helena office. We wrote to your office on November 30, 1990, stating that we would not be able to complete the SDR within 10 business days as required by 43 CFR 3165.3(d).

In your subsequent letter, dated December 12, 1990, you questioned our authority to revise the SDR timeframe. Please note, however, that we were not arbitrarily revising the review period as your letter concluded. Rather, we were waiting for the receipt of documents from the MBOGC and the Montana Oil Journal necessary to make our decision. As stated in the regulations, "The State Director shall issue a final decision within 10 business days of the receipt of a complete request for administrative review . . ." (emphasis added). For the record, we do not consider an SDR request complete until all related documents and materials have been received, whether from the appellant or from other sources.

Donald L. Gilchrist
Acting Deputy State Director
Branch of Mineral Resources

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